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In the Supreme Court of the United States

OCTOBER TERM, 1963.

No. 61.

ETHEL MEYER,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

MOTION OF LILLIAN WINTNER FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF LILLIAN WINTNER AS AMICUS CURIAE.

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ETHEL MEYER,

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vs.

UNITED STATES OF AMERICA,

Respondent.

MOTION OF LILLIAN WINTNER FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

Lillian Wintner respectfully moves this Court for leave to file the accompanying brief in this case as *amicus curiae*. The attorney for petitioner herein has refused to consent to the filing of such brief, but the attorney for respondent herein has consented to such filing.

The applicant's interest in this case arises from the fact that her petition for certiorari in the case of Lillian Wintner vs. United States of America, October Term, 1963, No. 98, is pending before the Court. There is an issue in her case (with respect to which the respondent did not oppose certiorari) which is substantially identical to an issue here. Accordingly, the Court's decision in this case may affect the outcome in her case if her petition for certiorari is granted.

The facts herein indicate that petitioner's husband pledged policies of insurance on his life to a bank as collateral security for the repayment of a loan prior to the time when a lien for unpaid federal income taxes arose

against these policies. In the petition for certiorari, Questions 1-5, inclusive, of the statement of "Questions Presented" and the "Reasons Relied on for the Allowance of the Writ" indicate that petitioner intends to confine her argument to the sole legal question of whether, because of the prior pledge of the policies to the bank, petitioner's husband had any property or rights to property remaining in the policies to which the Government's lien could attach.

The applicant believes there is an important question involved which is relevant to the disposition of this case but which may not be presented by the parties, although it was decided by the courts below. The applicant is of the opinion that a further issue is presented if it is held by the Court that the decedent had property or rights to property in the insurance policies notwithstanding their prior pledge to the bank. This question is:

> Where the bank's lien on the cash surrender value of the policies is superior to the lien of the United States, where the amount of the loans approximately equals the cash surrender value of the policies, where the applicable state law exempts the proceeds of the policies from claims of the insured's creditors, and where the principles of equity prohibit the marshaling of assets in such a situation, should the cash surrender value of the policies first be applied to pay the prior lien of the bank on the decedent's death so that almost nothing remains against which the United States might enforce its lien?

Unless the equitable doctrine of marshaling assets is applied, payment of the bank's prior lien on the cash surrender value practically exhausts that value and leaves nothing for the government.

Wherefore, so that the foregoing question may be presented, the applicant moves the Court for an order permitting the filing of the accompanying brief.

Respectfully submitted,

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BRIEF OF LILLIAN WINTNER, AMICUS CURIAE.

ARGUMENT.

The following argument proceeds on the assumption that the United States had a lien on the cash surrender value of Mr. Meyer's insurance policies during his lifetime, notwithstanding the fact that Mr. Meyer pledged the policies to a bank as collateral security for a loan prior to the government's assessment of the income tax deficiencies.

In *United States vs. Bess*, 357 U. S. 51 (1958), (wherein no pledge of the policies had been made) this Court held that the cash surrender value of an insurance policy is a separate fund to which a federal tax lien may attach and that at the death of the insured there is a transfer of this fund with the lien attached. This Court also held that the proceeds of a policy in excess of the cash surrender value (which amount is hereinafter referred to as "the excess") constitute another separate fund to which a tax lien may not attach. In the instant case, therefore, assuming that the government had a valid lien, this lien attached only to the cash surrender value of the policies, but the lien of the Huntington National Bank of Columbus, Ohio, attached to both the cash surrender value and to the excess.

The government's lien on the cash surrender value was second in priority to that of the bank on the cash surrender value, because the government's assessment was made after the pledge to the bank had been made. The first lien in time is the first in right. *United States vs. New Britain*, 347 U. S. 81 (1954).

At the time of Mr. Meyer's death, the cash surrender value was $27,285.87, the amount owing to the bank was $26,844.66, the tax deficiency was $6,159.09 plus interest,

and the excess was $22,714.13. The question which results is whether the $26,844.66 owing to the bank should have been paid from the fund consisting of the cash surrender value or from the fund consisting of the excess. If the bank was paid from the cash surrender value of $27,285.87, then only $441.21 remained of this fund for the United States; if it was paid from all of the $22,714.13 comprising the excess and from $4,130.53 of the cash surrender value, then $23,155.34 of the cash surrender value remained for the satisfaction of the United States' lien of $6,159.09 plus interest. This is a problem of resolving the rights of competing creditors.

The courts below applied the equitable doctrine of "marshaling assets," to the effect that when one creditor has a claim against two funds as security and another creditor has a claim against only one of the funds, the loan of the first creditor will be marshaled against that fund which is security for his loan only. See also *United States vs. Behrens*, 230 F. 2d 504 (2d Cir. 1956); *United States vs. Wintner*, 200 F. Supp. 157 (D. C. N. D. Ohio 1961), aff'd 312 F. 2d 749 (6th Cir. 1963). These courts determined that the bank had been paid out of the fund consisting of the excess, thereby leaving the fund consisting of the cash surrender value intact for satisfaction of the lien of the United States.

The problem thus narrows to an examination of the relevance of this doctrine of "marshaling assets" in resolving the rights of competing lienors where one of the liens is a United States income tax lien. This doctrine is a part of equity jurisprudence:

> "The doctrine of marshaling is not an absolute rule of law, or an absolute right, or a matter of legal right; marshaling is not founded on contract; nor is it a lien or a vested right or interest. It is founded in

> principles of natural justice, and is applied when the ends of justice require its application; it has regard to the rights of all who have interests in the property involved, and applies only when it can be applied equitably and with justice, both to the creditor and to his debtor, as well as to third persons, * * *" 55 C. J. S., *Marshaling Assets and Securities* § 1, p. 959.

Being a part of equity jurisprudence, the doctrine is not peculiar to either state law or to federal law alone, but may be found in both. Cf. *Sowell vs. Federal Reserve Bank*, 268 U. S. 449 (1925); *Scruggs vs. Memphis & Charleston R. Co.*, 108 U. S. 368 (1883).

In determining whether the equities of the parties require the application or non-application of the doctrine, the cases have held that reference to state law may be necessary. Thus, the weight of authority is that marshaling will *not* be invoked so as to deprive a debtor of property which has been exempted by state statute from the claims of creditors. This aspect of the doctrine has been stated as follows:

> "* * * The weight of authority holds that, in the light of the public policy purpose in the creation of homestead exemptions, marshaling cannot be invoked so as to deprive a debtor of his homestead or other exempt property; if one creditor may at his election resort to either the homestead or other property to satisfy his demand and another creditor can reach only the non-homestead property, the latter cannot compel the former first to resort to the homestead premises. Thus, a mortgagee of nonexempt land cannot compel a mortgagee of both homestead and nonexempt property to go against a homestead exclusively, nor can a judgment creditor whose judgment binds land other than the homestead put a mortgagee of both tracts to his election of the homestead as his security; * * *" 55 C. J. S., *Marshaling Assets and Securities* § 10, pp. 969-970.

See also 35 AM. JUR., *Marshaling Assets and Securities* § 16, pp. 393-394; Annotations in 44 A. L. R. 758 and 77 A. L. R. 371; 2 STORY, EQUITY JURISPRUDENCE § 871 (14th ed. 1918).

The federal courts have accepted this principle of the non-applicability of the doctrine of marshaling assets where one of the funds is exempt under state law. See *In re Bailey*, 176 Fed. 990 (D. C. Utah 1910); *In re Cogbill*, 2 Hughes 313, 6 Fed. Cas. No. 2954 (D. C. E. D. Va. 1877); Cf. *Moody vs. Century Savings Bank*, 239 U. S. 374 (1915); *Lockwood vs. Exchange Bank*, 190 U. S. 294, 300-301 (1903). But cf. *In re Meredith*, 144 Fed. 230 (D. C. N. D. Ga. 1906); *Abbott vs. Powell*, 6 Sawyer 91, 1 Fed. Cas. No. 13 (D. C. Calif. 1879); *In re Sauthoff*, 7 Biss. 167, 21 Fed. Cas. No. 12379 (D. C. W. D. Wis. 1876).

Under Section 166 of the Insurance Law of the State of New York, the proceeds of insurance are exempt from the claims of creditors of the insured:

> "1. If any policy of insurance has been or shall be effected by any person on his own life in favor of a third person beneficiary, or made payable, by assignment, change of beneficiary or otherwise, to a third person, such third person beneficiary, assignee or payee shall be entitled to the proceeds and avails of such policy as against the creditors, personal representatives, trustees in bankruptcy and receivers in state and federal courts of the person effecting the insurance * * *."

Accordingly, the doctrine of marshaling assets is not applicable to this case.

The non-applicability of the doctrine of marshaling assets is not limited to cases where the exempt fund is homestead property. Thus, in the leading case of *Barbin vs. Moore*, 85 N. H. 362, 159 Atl. 409 (1932), Mr. Laclerc borrowed $9,000 from a bank and pledged two insurance

policies as collateral security for the repayment thereof; he also gave a mortgage on his real estate to the bank. The beneficiaries of the insurance policies were his children. When Mr. Laclerc died, there was still a sum owing to the bank. The insurer paid the bank that sum, and the bank discharged the mortgage. The administrator of Mr. Laclerc's estate then sold the real estate, and the guardian of the children sought to recover from the administrator the amount which had been paid to the bank from the insurance proceeds. The administrator was in the position of representing other creditors of the decedent, since if the children were able to recover from the estate the amount which had been paid from the insurance proceeds, then the estate would have been insolvent. Noting that the bank had a lien both on the insurance policies and on the real estate while the other creditors had a claim against only the real estate, the creditors of the estate sought to apply the doctrine of marshaling assets in order to require a holding that the bank had received payment from the insurance policies, so that the funds resulting from the sale of real estate would be available solely to them. The Supreme Court of New Hampshire rejected this contention, saying:

> "* * * Assuming that the defendant is in a position to assert a right to marshaling as far as the nature of the claims he represents is concerned, the question to be considered is whether occasion for such relief is shown. The bank having two funds to look to and the general creditors but one, they assert the right to compel the bank to take its pay from the fund not available to them.
>
> "The statute is a conclusive answer to the claim thus made. As to the insurance, the beneficiaries' rights are superior to those of the creditors. In the language of the statute, the beneficiaries hold the insurance against the claims of the creditors or repre-

sentatives of the party effecting the same.' P. L. c. 277, § 2. * * * In a very practical sense the defendant here seeks to assert a claim upon the insurance. This the statute forbids.

* * *

"And it may be added that marshaling is never ordered to the prejudice of a third party having equal equity. The statute having made the claims of the beneficiaries superior to those of general creditors, it is clear that this rule forbids the application of marshaling as against the former and in favor of the latter." 159 Atl. 409, 416-417.[1]

It is therefore clear in the instant case that the United States cannot require the Huntington National Bank of Columbus to be repaid from the excess and that the bank instead collected from the cash surrender value of the policies, leaving only $441.21 to be applied against the United States lien.[2]

The reference to the state-created exemption[3] under

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[1] See also West Grove Savings Bank vs. Dunlavy, 190 Iowa 1054, 181 N. W. 404 (1921), and Pugh vs. Whitsitt, 161 S. W. 953 (Tex. Civ. App. 1913), refusing to apply the doctrine where a head-of-a-household exemption was involved. The same public policy which requires the non-applicability of the doctrine where exempt homestead property is involved also requires its non-applicability where exempt insurance proceeds are involved. Any reliance on *Behrens, supra*, to the contrary is misplaced, since there the court simply recited the broad doctrine of marshaling assets; it did not consider the effect of exempt property on that doctrine. Any reliance on Merchants' & Mechanics' Bank v. Sewell, 61 F. 2d 814 (5th Cir. 1932), is misplaced for the same reason and also because the proceeds of the policies were not involved, the insured not having died.

[2] The United States cannot proceed against the excess on a transferee theory because of Section 166 of the Insurance Law of the State of New York. Commissioner vs. Stern, 357 U. S. 39 (1958).

[3] This reference to a state-created exemption does not violate the rule that the government is not subject to state exemp-

(*Continued on following page.*)

Section 166 to determine the applicability of the doctrine of marshaling assets in this case is proper under the prior holdings of this Court. In *Aquilino vs. United States*, 363 U. S. 509 (1960), this Court held that the first question in any tax lien case is whether and to what extent the taxpayer had "property" or "rights to property" to which the tax lien could attach. This is resolved by state law's determining the nature of the legal interest which the taxpayer had in the property. See *Bess, supra*. As noted above, *amicus* is here assuming that Mr. Meyer had such an interest to which the lien of the United States could attach, notwithstanding his prior pledge of the policies to the bank; otherwise, the issue of the applicability of the doctrine of marshaling assets is not reached.

This Court has also heretofore made it clear that once the tax lien has attached to the taxpayer's state-created interests, federal law determines the priority of competing liens asserted against the taxpayer's "property" or "rights

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(*Continued from preceding page.*)

tion laws in collecting tax liabilities. See *Bess, supra;* Fink vs. O'Neil, 106 U. S. 272 (1882); United States vs. Hoper, 242 F. 2d 468 (7th Cir. 1957); Fried vs. New York Life Insurance Co., 241 F. 2d 504 (2nd Cir.), cert. denied *sub nom.* Fried vs. United States, 354 U. S. 922 (1957); United States vs. Heffron, 158 F. 2d 657 (9th Cir. 1947); Kyle vs. McGuirk, 82 F. 2d 212 (3rd Cir. 1936); Cannon vs. Nicholas, 80 F. 2d 934 (10th Cir. 1935); Knox vs. Great West Life Assurance Co., 109 F. Supp. 207 (D. C. E. D. Mich. 1952), aff'd. 212 F. 2d 784 (6th Cir., 1954); Smith vs. Donnelly, 65 F. Supp. 415 (D. C. E. D. La. 1946). These cases hold only that state statutes which exempt certain property from the claims of creditors may not be applied to prevent the *attachment* of the government's lien for taxes. This principle is not disputed here. If Mr. Meyer's pledge of the policies to the bank did not dispose of all of his property or rights to property in the policies, then a lien did arise upon the cash surrender value of the policies in favor of the government, and the New York statutes cannot prevent the attachment of this lien. But this is not the answer; it is only the assumed starting point. The question which must be answered, and upon which the above cases do not bear, is from which fund the bank was paid.

to property." *United States vs. Buffalo Savings Bank*, 371 U. S. 288 (1963); *Aquilino, supra; United States vs. Acri*, 348 U. S. 211 (1955); *New Britain, supra*. However, there is no problem of determining priorities here since there is no question that the bank's lien, being prior in time, was prior in right to that of the United States. *New Britain, supra*. The doctrine of marshaling assets is not reached, in fact, unless the problem of priority has first been resolved.

The doctrine of marshaling assets, being a principle of equity jurisprudence, is of that body of law which is peculiar to neither federal nor state law. It is, however, undeniably a part of federal law. It requires an examination of the equities of the parties. One of these equities is the exemption of insurance proceeds decreed by the statutorily-expressed public policy of the State of New York. 35 AM. JUR., *Marshaling Assets and Securities* § 16, pp. 393-394.

Furthermore, the prior decisions of this Court have not excluded any reference to state law even in resolving the rights of competing creditors. On the contrary, in dealing with the problem of the divestiture of federal liens in foreclosure proceedings, in *United States vs. Brosnan*, 363 U. S. 237 (1960), this Court held that there is no federal law with respect to creditors' rights and that the enforcement of such rights is a matter of state law:

> "We nevertheless believe it desirable to adopt as federal law state law governing divestiture of federal tax liens, except to the extent that Congress may have entered the field. It is true that such liens form part of the machinery for the collection of federal taxes, the objective of which is 'uniformity, as far as may be.' United States vs. Gilbert Associates, Inc., 345 U. S. 361, 364. However, when Congress resorted to the use of liens, it came into an area of complex property relationships long since settled and regulated by state

law. We believe that, so far as this Court is concerned, the need for uniformity in this instance is outweighed by the severe dislocation to local property relationships which would result from our disregarding state procedures. Long accepted non-judicial means of enforcing private liens would be embarrassed, if not nullified where federal liens are involved, and many titles already secured by such means would be cast in doubt. We think it more harmonious with the tenets of our federal system and more consistent with what Congress has already done in this area, not to inject ourselves into the network of competing private property interests, by displacing well-established state procedures governing their enforcement, or superimposing on them a new federal rule. Cf. Board of County Commrs. vs. United States, 308 U. S. 343." 363 U. S. 237, 241-242.

In *Commissioner vs. Stern*, 357 U. S. 39 (1958), this Court expressly required reference to state law to determine transferee liability, stating:

"* * * Since the federal courts no longer formulate a body of federal decisional law for the larger field of creditors' rights and diversity cases, any such effort for the small field of actions by the government as a creditor would be necessarily episodic. That effort is plainly not justified when there exists a flexible body of pertinent state law continuously being adapted to changing circumstances affecting all creditors. Accordingly we hold that, until Congress speaks to the contrary, the existence and extent of liability should be determined by state law." 357 U. S. 39, 45.[4]

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[4] Congress has not acted in this area, since Section 7403 of the Internal Revenue Code of 1954 (26 U. S. C. 1958 ed., Sec. 7403) merely provides a forum for the enforcement of the tax lien, and Sections 6321, 6322, and 6323 of the Internal Revenue Code of 1954 (26 U. S. C. 1958 ed., Secs. 6321, 6322, 6323) merely create the federal tax lien, the period of its existence, and its validity against certain persons. None of these statutes deals with the problems involved in this case.

Thus, in determining the applicability of the doctrine of marshaling assets, reference to state law is proper for three reasons:

1. The doctrine of marshaling assets does not involve a problem of priority, but instead assumes that this problem has been resolved;
2. The doctrine is a part of federal law and requires an examination of the equities of the parties, one of which is exemptions created by state law;
3. This Court has previously approved reference to state law in tax lien situations, even if the problem involved went beyond a determination of the taxpayer's property or rights to property.

Therefore, (1) where two funds exist, one consisting of the cash surrender value of insurance policies and the other consisting of the excess of the proceeds of these policies over the amount of the cash surrender value, (2) a bank [5] has a lien on both of these funds and the United States has a lien only on the fund consisting of the cash surrender value, (3) the bank's lien on the cash surrender value is superior and prior to that of the United States on the cash surrender value, and (4) a state statute exempts the excess fund from claims of creditors, the doctrine of marshaling assets will not be applied. Accordingly, all of the cash surrender value of the policies involved in the instant case except $441.21 was exhausted in paying the Huntington National Bank of Columbus, leaving only that amount to satisfy the lien of the United States.

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[5] A result contrary to that in Behrens, *supra*, Wintner, *supra*, and the instant case has been reached in cases where the insured borrowed from, and pledged his policies to, the insurer rather than a bank. See United States vs. Pilley, 6 AFTR 2d 5995 (D. C. W. D. Tenn. 1960); Flax vs. United States, 179 F. Supp. 408 (D. C. N. J. 1959).

CONCLUSION.

For all of the foregoing reasons, the decision of the court below is erroneous and should be reversed.

Respectfully submitted,

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